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SUBJECT: FOREIGN CURRENCY LOANS: HOW HARD WILL BORROWERS BE HIT?

REF: BUDAPEST 1006

¶1. (U) Although most hope and expect the recently announced IMF assistance package will help strengthen and stabilize Hungary's currency, the recent weakening of the forint has caused many to consider the impact a weakened currency will have on the large number of households holding foreign currency-denominated home and automobile loans in Hungary.

HUGE JUMP IN FOREIGN CURRENCY BORROWING

¶2. (U) Recent news reports have focused on the high number of foreign currency-denominated loans in both the corporate and household sectors in Hungary. The rapid increase of such loans to households in the past five years is particularly pronounced - jumping from only five percent of all household loans in 2003, to 62 percent during the first half of 2008. OTP Bank CEO Sandor Csanyi attributes this to government policies which "effectively subsidized" Swiss franc and euro-based loans beginning in 2002. Despite exchange rate risks, lower interest rates on Swiss franc and euro loans caused Hungarians to increasingly use them to finance home and automobile purchases. The value of foreign currency loans to households totaled HUF 3.2 trillion (USD 15.1 billion) in 2007, and HUF 3.7 trillion (USD 17.3 billion) during the first half of 2008.

¶3. (U) As the global financial crisis hits Hungary (reftel), the forint has rapidly weakened relative to major currencies, including the euro and the Swiss franc. As the forint declines, borrowers must pay increasing amounts to cover the same monthly loan bill.

HOW EXPOSED ARE HUNGARIAN HOUSEHOLDS?

¶4. (SBU) The increase in the cost of the foreign currency loans to Hungarian borrowers depends on the difference between the exchange rate at the time of the origination of the loan, and the current exchange rate. Based on recent exchange rates, euro-denominated loans originating during the past five years would be on average between 5 and 11 percent higher. Loans originating in July 2008, however, when the forint was at its strongest against the euro (231 forints to the euro), are now 16 percent more expensive.

¶5. (SBU) The situation is even more pronounced for Swiss franc-denominated loans. Households originating Swiss franc-denominated loans during the past five years would find their loans between 10 and 17 percent higher based on current exchange rates. However, anyone originating a loan in July 2008, when the forint was its strongest (143 forints to the franc), would now find their loan to be nearly 25 percent higher.

¶6. (SBU) The forint has recovered some of its previous value in the past several days since the announcement of the IMF assistance package. The currency is still down considerably from its mid-summer highs, however, and most analysts still expect some volatility as Hungary implements its assistance package and as impact of the global financial crisis reveals itself in other emerging markets in unexpected ways.

GOVERNMENT ANNOUNCES HELP FOR BORROWERS

¶7. (U) Last week Prime Minister Gyurcsany announced an agreement with the Hungarian Banking Association to help reduce the impact on households of higher loan repayments caused by a weakened forint. The agreement will give borrowers greater flexibility in loan terms, namely allowing an increase in the number of payments in order to help limit the increase in monthly bills for borrowers. It also provided greater flexibility to convert loans from foreign currencies to forints. National Bank Governor Andras Simor ruled out any direct assistance to borrowers, however, noting that, "foreign currency debtors should not be saved, since we finally have to learn that there is no such thing as a free lunch."

COMMENT

¶8. (SBU) To the extent that the IMF agreement helps stabilize the forint at previous years' levels, Hungarian foreign currency borrowers may be spared from what could have been a heavy hit to their pocketbooks. The events over the last few weeks, however, brought to light for many the risks of foreign currency loans. Simor admits privately, however,

that there are "no effective tools" to limit this borrowing, and concludes that Hungarians will "have to learn to do the right thing simply because it is the right thing."
Foley